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MICHAEL RODAK, JR., C

No. 74-124

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1974

Blue Chip Stamps, et al.,

Petitioners,

v.

Manor Drug Stores, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The majority and dissenting opinions of the Court of Appeals for the Ninth Circuit are set

forth in the separate Appendix at App. 133 through 153 and modifications by the panel thereto are found at App. 154 through 156. The modified opinions are reported in 492 F.2d 136. The opinion and order of the district court are set forth at App. 123 through 131 and are reported at 339 F. Supp. 35.

JURISDICTION

On October 15, 1973, a panel of the court of appeals entered its decision reversing the district court's dismissal of the amended complaint. The matter was ordered remanded for further proceedings. (App. at 142.) On October 26, 1973, a justice of the court of appeals extended the time for petitioning for a rehearing in banc and ordered the mandate stayed. Timely petitions for a rehearing in banc were then filed. On April 1, 1974, an order was entered denying the petitions and making minor changes in the panel's

opinions. Five active circuit judges noted that they would have granted a rehearing in banc. (App. at 154-56.) On June 21, 1974, Mr. Justice Douglas extended the time for filing a petition for certiorari to and including August 15, 1974. The petition was filed on August 15, 1974, and the writ granted on November 11, 1974. On December 23, 1974 petitioners requested an extension of time within which to file their opening brief herein and on December 26, 1974 the Court extended the time to and including December 31, 1974. Respondent received petitioner's brief on January 2, 1975. The Court's jurisdiction has been invoked pursuant to 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Do Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5

of the Securities and Exchange Commission deny standing in a civil damage action to a plaintiff who has a right or entitlement to purchase securities but is deprived of exercising said right or entitlement because of the fraud of the offeror?

2. Does permitting standing to sue under section 10(b) of the Securities Exchange Act of 1934 to persons who had a right or entitlement to purchase offered securities and who would have so purchased but for the alleged fraud of the petitioners irreconcilably conflict with the disclosure purposes of the Securities Act of 1933?

(Petitioners have presented to the Court the following question which respondent does not concede is a viable or dispositive issue in this action.)

3. Can a person who is not a party to a federal antitrust consent decree assert in a separate action rights alleged to derive from that decree?

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides in pertinent part:

"§ 78j. Manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, of any facility of any national securities exchange--

". . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated by the Securities and Exchange Commission, provides as follows:

"§240.10b-5 Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any practice, or course of business which would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Section 28 of the Securities Exchange Act of 1934, 15 U.S.C. §78bb, is set forth in pertinent part as Appendix "A" to this brief at Br. App. 1.

STATEMENT OF THE CASE

Respondent, Manor Drug Stores and others similarly situated comprise a specific class of persons[1] who were entitled to but were dissuaded from purchasing securities of Blue Chip Stamps as a result of the alleged fraudulent activities of petitioner Blue Chip Stamps, Blue Chip

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[1] This class of persons has been denominated throughout these proceedings and in the antecedent antitrust action as "Users", a term used to describe retail issuers of Blue Chip Stamp Company who issue such stamps to their customers as a reward for their patronage. (App. at 9.)

Stamp Company and named directors and major shareholders of Blue Chip Stamps.[2]

Respondent filed this action for damages in federal district court on November 10, 1970,[3] and on March 5, 1971, petitioners moved for dismissal of the action, which motion was granted on May 25, 1971, by J. Kelleher (App. at 123 through 131). The basis for the district court's dismissal was the speculativeness of plainitiff's damages and the alleged continuing validity and

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2 Specifically, the named defendants-petitioners in this litigation are: Blue Chip Stamps, a corporation, Blue Chip Stamp Company, a merged corporation, Lucky Stores, Inc., Market Basket, a corporation, Purity Stores, Inc., Ralphs Grocery Company, a corporation, Safeway Stores, Inc., Thriftimart, Inc., Vons Grocery Co., a corporation, Robert E. Alexander, Donald A. Koeppell, Leonard Straus, William F. Ramsey, Robert E. Laverity, Richard Ralphs, John R. Niven, Fred Von Der Ahe.

3 Prior to service of the original complaint, respondent filed and served an amended complaint, which constitutes the sole pleading before the Court and which is set forth with Exhibits thereto at App. 4 through 122.

sound policy of the purchase or sale limitations established in Birnbaum v. Newport Steel Corp., 193 F. 2d (2d Cir. 1952), cert. denied, 343 U.S. 456 (1952).

Respondent appealed to the United States Court of Appeals for the Ninth Circuit and, on October 15, 1973, that court in a 2-1 decision issued its Opinion (App. at 133 through 153) reversing the lower court's dismissal and remanding the case for further proceedings. The basis of the court of appeals decision was that the consent decree involved herein served the same function as did the contractual relationship found in other cases wherein standing was found to exist under Section 10(b) and Rule 10b-5 despite the Birnbaum restriction (App. at 141 and 155).

Petitioners thereupon applied for a rehearing in banc, which was denied on April 1, 1974 (App. at 154 through 156).

STATEMENT OF FACTS

This is an action which is based upon a unique set of facts and which seeks damages under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10(b)-5. [4]

The facts as alleged in the amended complaint and which in light of the trial court's dismissal, are deemed to be true, show the following:

As a result of various alleged violations of the Sherman Anti-Trust Act, the United States government filed a civil action in 1963 against Blue Chip Stamp Company and all of the corporate shareholder defendants named herein. (App.

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4 The amended complaint also sought damages for violations of §12 of the Securities Act of 1933, but the viability of the causes of action based upon said Act have not been urged during the appellate process and are not, therefore, before this Court.

at 8, 23.) Permitted appearance in said action was the Attorney General of the State of California on behalf of users other than those who were shareholders of Blue Chip Stamp Company and various trade associations, including the California Grocers Association and Certified Grocers of California, Ltd., each of whom included within their constituency a proportion of users herein. (App. at 10.)

All of said Users' representatives contended before the trial court that they, in fact, owned an interest in the defendant, Blue Chip Stamp Company and the Twenty Million Dollars in profits it had accumulated during the five years immediately prior thereto, and that in any decision of said government case, the ownership of said users of an interest in the said defendant, Blue Chip Stamp Company, should be decreed. (App. at 10.)

On June 5, 1967, a Consent Decree (App. at 23 through 35) was entered in the anti-trust

action, which decree called for a plan of reorganization to be submitted to and approved by the court. (App. at 27.) The third attempt at a satisfactory plan of reorganization (App. at 40 through 54) was subsequently lodged with and approved by the court and made a part of the Consent Decree (App. at 8).

The approved plan of reorganization required among other things the formation of a "new company", which was later entitled Blue Chip Stamps, and the divestment of the ownership interest of the shareholder defendants herein. (App. 9.) Also, and most significantly, said approved plan called for an offering of approximately 621,600 shares of the common stock of Blue Chip Stamps to "users" of Blue Chip Stamps on a pro rata basis to be determined by the quantity of stamp pads issued to "users" during a designated prior period. The offering was to be made in "units" consisting of three shares of the newly formed company and one $100.00 debenture for a cash consideration

of $101. (App. at 9.)

It is alleged that the foregoing described offering to the users was a bargain, intended by both the court and the parties, in that the reasonable market value of said units at the time of the offering was at least $315.00, or a net bargain to the users of $214.00 per unit. (App. at 11.) It is further alleged in the amended complaint that the said offering to the users versus the investing public at large and the bargain price were prompted by the claims and contentions by and on behalf of the users and their representatives during the antitrust proceedings and, particularly, in arguments before the court in hearings regarding the proposed plans for reorganization. (App. at 10.) [5]

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5 These claims and contentions and the recognition of their validity by petitioners' own counsel in the antitrust action are set forth in Appendix "B" of this brief and digested and discussed, infra, in the Argument portion of this brief.

Pursuant to the approved plan of reorganization and Consent Decree, Blue Chip Stamps was formed in about July, 1968, and issued 621,600 shares of stock to the stockholders of Blue Chip Stamps Company (of which approximately 560,000 shares went to the defendants herein); 27,600 shares were reserved for offering to certain of its employees; 10,400 shares were reserved for issuance pursuant to its qualified Stock Option Plan; and an additional 621,600 shares were earmarked for offering to the users of Blue Chip Stamps, including respondent herein.

As part of the offering to the users, petitioners caused to be published and delivered to said users a prospectus dated August 29, 1968 (App. at 55 through 90), which prospectus constituted a deceptive and manipulative device in that it contrived negative aspects to the offering and over-emphasized or fabricated adverse contingencies. Specifically, said "negative prospectus" unjustifiably warned the offeree-users that:

(1) the net income from the current fiscal year would be adversely affected by payment of $7,928,000.00 in settlement of claims against Blue Chip Stamps; (2) net income would be adversely affected by a substantial decrease in the use of trading stamps; (3) net income would be adversely affected by a sale of one-third of the company's trading stamp business in California; (4) claims or causes of action against the company aggregated approximately $29,000,000.00; and, (5) all but two of the present directors were precluded from continuing to serve on the company's board of directors until June 5, 1977. (App. at 13 through 15, 55 through 90.)

In truth and in fact, said representations were false or should have been known to be so in that, for instance, the $29,000,000.00 in purported claims and causes of action were settled by the defendants for less than $1,000,000.00 less than three months later and some of which were settled prior to the issuance of the "negative pros-

pectus". (App. at 15.)

The aforesaid negative aspects of Blue Chip Stamps securities were not included in a public offering and prospectus made one year later (App. at 91 through 122), despite the fact that to the extent they were relevant at the time of the offering to respondent herein they would have been relevant at the time of the offering to the general public. (App. at 15.)

These misrepresentations and instances of over-emphasis were not without design or purpose. The petitioners emphasized said "negative prospectus" in order to accomplish the desired effect of enhancing the value of their own stock holdings in Blue Chip Stamps and creating a premium price for future sales of Blue Chip Stamps securities on the public market. (App. at 13.)

The respondent herein represents the approximate forty percent (300,000 shares) of users who were entitled to but were dissuaded by the

above described "negative prospectus" from exercising their entitlement to purchase Blue Chip Stamps securities. Respondent seeks damages, which are mathematically computed at $21,400,000.00, or the right to purchase their prescribed amount of shares at the original offering price at the 1968 users' offering.

SUMMARY OF ARGUMENT

The facts in the instant case present a unique circumstance in Section 10(b) litigation in that the respondent, while technically not a purchaser or seller, owned a "right" to purchase the securities offered by petitioners. That "right" served as the functional equivalent of a contractual relationship, a basis upon which Courts have historically granted standing under §10(b). Because of this unique right and the facts peculiar to this case, the decision below has singular application to the case at bar and, as so distin-

guished, does not create a conflict with the Securities Act of 1933 or act as a harbinger of a flood of unmeritorious lawsuits under federal securities laws.

Also, the decision below does not overrule or joepardize previous rulings of this and other courts to the effect that a consent decree may not be enforced by a non-party thereto.

ARGUMENT

I.

GRANTING STANDING TO SUE UNDER §10(b) TO A PERSON WHO HAS AN ENTITLEMENT EQUIVALENT TO THAT OF A CONTRACT RIGHT TO PURCHASE SECURITIES COMPORTS WITH THE PURPOSES AND POLICIES OF THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES ACT OF 1933.

A. The Purchaser-Seller requirement is a court created restriction and its application has

been significantly limited throughout the circuits.

The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted by Congress as a means of alleviating and punishing abuses which had occurred and continued to occur in the securities market and which had been the major contributing causes of the stockmarket crash of 1929.[6] Language expressly granting a private right of action for civil damages for violations of section 10(b) and Rule 10b-5 is not found in those provisions or otherwise in the Act itself. Since 1946 and the decision of Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa.), however, the courts have universally accepted the

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6 H. R. Rep. No. 1383, 73d, Cong., 2d Sess., 2 (1934); S. Rep. No. 1455, 73d Cong., 2d Sess., 81 (1934).

proposition that a private right of action under 10(b) and 10b-5 does exist. [7]

In first recognizing this right to civil remedies under 10(b) and 10b-5 the court in Kardon held:

> "Where, as here, the whole statute discloses a broad purpose to regulate securities transactions of all kinds and, as a part of such regulation, the specific section in question provides for the elimination of all manipulative or deceptive methods in such transactions, the construction contended for by the defendants may not be adopted. In other words, in view of the general purpose of the Act, the mere omission of an express provision for civil liability is not sufficient to negative

[7] This Court has confirmed that a private right of action is implied under §10(b). Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 13, n. 9.

> what the general law implies." 69 F. Supp. at 514.

Just as the Act and regulations are silent with respect to the availability of civil redress in private actions, so, too, are they mute regarding what has developed to be known as the purchaser-seller limitation. Section 10(b) is phrased in general, broadly encompassing language. Its relevant proscription states that it shall be unlawful for any person:

> "To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules or regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

The quoted statute does not limit standing to assert a violation of its provisions to a purchaser or seller; likewise, Rule 10b-5 makes no such restriction. The purchaser-seller require-

ment, as such there is, was created by a court of law in the case of Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952). While respondent submits that the Birnbaum case stands for no more than the singular proposition that 10(b) may not be used as a means of redress for corporate mismanagement where the complaining party held no interest in the questioned securities transaction, in light of the reliance placed upon that case by petitioners a discussion of its facts is called for.

In Birnbaum, the defendant corporation was negotiating with Follansbee Steel Corp., for a merger which would have been highly profitable to defendant's stockholders. Pursuant to a fraudulent scheme, Feldmann, president of the defendant corporation, called the merger off and sold his stock to another corporation, Willport Company, at double its then market value. This sale of stock gave Willport Company control over the defendant corporation. The alleged fraud concerned

certain misrepresentations contained in letters sent by the defendants to plaintiff stockholders which provided false information concerning the aborted merger and the Feldmann sale. The plaintiffs, defendant corporation stockholders, brought an action under §10(b) alleging that they had been damaged as a result of the Feldmann sale and the termination of the merger negotiations in that they had been deprived of an increase in the value of their stock.

The plaintiffs contended that the Feldmann sale satisfied the 'in connection with purchase or sale of a security' requirement of §10(b); however, at no time were the plaintiffs in any way parties to the transaction, but rather, were mere bystanders. What the plaintiffs were really seeking was a cause of action for a breach of fiduciary duty on the part of the directors of the defendant corporation. The Court realized this and held that fraud perpetrated upon a purchaser or seller of securities has no relation to breaches of fi-

duciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers.

The plaintiffs in Birnbaum were not purchasers, sellers, offerors, or offerees, nor did they enjoy any type of unique status which would constitute a rational and causal nexus with the challenged securities transaction. Those plaintiffs were mere bystanders to the stock sale who attempted to employ 10(b) as a means of punishing management's breach of its fiduciary duties. Respondent has urged throughout these proceedings that Birnbaum, so limited, is a correct proposition of law.[8] Unfortunately, many cases

8 Respondent believes this analysis of Birnbaum to be consistent with the expression of this Court in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 13-14, n. 10, although the Court did not reach the Birnbaum issue.

subsequent to Birnbaum attributed to it a much broader scope and applied its holding as a standing requirement to all 10(b) actions.

Due to the unfairness which had developed as a result of the Birnbaum purchaser-seller limitation, courts began to search for and find alternatives to this "standing" requirement. Thus, acknowledged exceptions to the purchaser-seller requirement emerged. In the twenty-two years since Birnbaum was decided, therefore, we have seen the courts grant "standing" to plaintiffs who found themselves in the position of being "forced sellers"[9] where the only securities transaction had been a corporate merger[10] or

9 Vine v. Beneficial Financial Company, 374 F. 2d 627, cert. denied, 389 U.S. 970; Dasho v. Susquehanna Corp., 380 F. 2d 262 (7th Cir. 1967); Mader v. Armel, 402 F. 2d 158 (6th Cir. 1968), cert. denied, 394 U.S. 940 (1969).

10 Coffee v. Permian Corp., 434 F. 2d 383 (5th Cir. 1970).

issuance by a corporation of its own shares [11]; to a plaintiff which was a stock brokerage firm and had ordered securites for which its customers later refused to pay [12]; to plaintiffs who were frustrated in their alleged attempt to purchase securities [13]; and to plaintiffs who had unwittingly purchased non-existent stock. [14]

In each of the above categories of exceptions none of the plaintiffs could be said to have been an actual or technical purchaser or seller. Yet, in each case the court found that the remedial

11 Hooper v. Mountain States Securities Corp. 282 F.2d 195 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961); Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964); Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969).

12 A. T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967).

13 Commerce Reporting Co. v. Puretec, Inc., 290 F. Supp. 715 (S.D.N.Y. 1965).

14 Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967).

purposes of the Act intended that the type of fraud alleged was of the ilk intended to be outlawed by 10(b) and for which a private damage action should lie.

The Perlow, Puretec and Hentz cases cited below and the case of Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D.N.Y. 1956) are representative of the class of exceptions to the Birnbaum rule which has come to be known as the aborted purchaser or seller, or causation, exception. [15] In Stockwell, for instance, the plaintiffs were fraudulently induced to retain their shares rather than sell them. The court in considering the Birnbaum case and still granting standing stated:

15 See, also, Neuman v. Electronic Specialty Co., [1969-1970 Transfer Binder] C.C.H. Fed. Sec. L. Rep. para. 92, 591 (N.D. Ill. 1969)| The Second Circuit which decided Birnbaum has abandoned the purchaser-seller limitation in injunction cases. Mutual Shores Corp. v. Genesco, Inc., 384 F.2d 540 (1967).

". . . The rationale of Birnbaum was that the case involved fraudulent mismanagement of corporate shares rather than fraudulent practices in connection with the purchase or sale of securities.

". . . Considering the purposes underlying the Securities Exchange Act and Section 10(b) and Rule 10b-5, which are to protect investors from fraud, it follows that a seller is injured as much when he suffers a loss on the sale of securities which he has been fraudulently induced to retain as when he is fraudulently induced to sell them." 252 F. Supp. at 219.

The Puretec case, 290 F. Supp. 715 (S. D. N. Y. 1965) expanded the Stockwell rationale to a situation where plaintiffs had been frustrated in their attempt to purchase securities. Discounting an interpretation similarly urged herein by petitioners, the court noted that:

". . . [T]he construction urged by the defendant would not only fly in the face of that

objective, but render unnecessary the words 'in connection with'. Its effect would be to artificially restrict the statute to proscription of fraud 'in the purchase or sale' rather than 'in connection with' the purchase and sale of a security. The use of the words 'in connection with' indicates that Congress intended to protect against fraud in agreements to buy or sell, as well as with respect to completed sales, provided damages could be shown. Here, for instance, the plaintiffs allege in substance that but for the defendants' fraud, their purchase of the stock of Puretec would have been consummated." 290 F. Supp. at 718-19.

The above cases are mentioned to demonstrate that the Birnbaum rule is not dictated by the language of either section 10(b) or rule 10b-5. This is clear from the provision of the section and rule that fraud only be "in connection with" the purchase or sale of a security and from the

many exceptions which have arisen in avoidance of Birnbaum. Further, the wording of other sections of the Federal Securities Laws may shed light on Congressional intent with respect to a purchaser-seller requirement. [16]

[16] Section 5(c) of the 1933 Act speaks in terms of offers to sell or offers to buy, Section 12 of that Act establishes a cause of action against a person who "offers or sells" a security, Section 17 of the Securities Act proscribes certain conduct "in the offer or sale of any securities," Section 9(a)(2) of the 1934 Act outlaws some manipulative acts "for the purpose of inducing the purchase or sale" of a security, Sections 9(a)(3) and 9(a)(4) of the Exchange Act proscribe certain manipulative activities if a person is "selling or offering to sell or purchasing or offering to purchase the security," Section 14(e) of the 1934 Act prohibits fraudulent practices "in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request or invitations," Section 15(c)(1) of that Act provides that no broker-dealer may "effect any transaction in, or . . induce the purchase or sale of, any security" in violation of the SEC's rules, a broker-dealer may not "effect any transaction in, or . . . induce or attempt to induce the purchase or sale of, any security" under Section 15(c)(3) of the 1934 Act unless he is in conformity with the net capital rules, the short-swing profit provision found in Section 16(b) of the Exchange Act speaks in terms of "purchase or sale," and Section 18(a) establishes a private right of action for false filings when the plaintiff "purchased or sold a security."

This erosion in the strict application of the Birnbaum doctrine has been discussed at length by commentators, many of whom have called for its total demise. [17] During the proceedings below and before this Court as amicus curiae, the Securities and Exchange Commission has urged that the Birnbaum rule be abolished in toto.

[17] Comment, The Purchaser-Seller Rule: An Archaic Tool for Determining Standing under Rule 10b-5, 56 Geo. L.J. 1177, 1178 (1968); Note, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 Cornell L. Rev. 684, 698 (1968); Lowenfels, The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5, 54 Va. L. Rev. 268, 275-276 (1968); Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b-5, 14 Vill. L. Rev. 499, 501-502 (1969); Ruder, Current Developments In the Federal Law of Corporate Fiduciary Relations--Standing to Sue Under Rule 10b-5, 26 Bus. Law, 1289 (1971).

In fact, since entry of the decision below one circuit has wholly abandoned the Birnbaum doctrine. In Eason v. General Motors Acceptance Corporation, 490 F.2d 654 (7th 1973), there did occur a sale of securities, but the parties to the sale were a defendant and another party. It was a securities transaction in which the plaintiffs were not participants. Plaintiffs were shareholders of Bank Service Corporation (not a party to the action), which issued 7,000 of its shares to defendant Waite in exchange for all of the assets of the latter company. As further consideration for the acquisition, BSC assumed all liabilities of Waite, including notes payable to GMAC for which GMAC required and obtained personal guarantees by plaintiffs. BSC later defaulted on the notes and in a separate action GMAC sued plaintiffs on their guarantees. It was discovered, however, that both Waite and GMAC had made material misrepresentations concerning the true value of the former's assets and plaintiffs then

brought this §10(b) action.

These facts show that the Eason plaintiffs were not purchasers or sellers, nor parties to a contract of purchase or sale, nor were they holders of a right which might be deemed an equivalent to a contractual right to purchase or sell securities. Nevertheless, they were granted standing under §10(b). Upon analyzing the Birnbaum decision and articulating its actual, limited holding, the Court in Eason suggests that the real issue in determining the availability of §10(b) relief should not be one of "standing", but rather, whether plaintiffs are members of the class for whose special benefit Rule 10b-5 was adopted.

The Eason decision then established a test for determining whether a plaintiff comes within the intended class of protected persons:

> "Congress, the Supreme Court, and the [Securities Exchange] Commission have all used the term 'investors' to describe the class of persons protected by Rule 10b-5. Thus,

the statutory authorization for the rule refers to the prohibition of deceptive devices 'for the protection of investors'." (Insert ours) 490 F. 2d at p. 659.

The court, however, does not suggest that the term "investors" be construed in the technical sense of a shareholder. "Investor" is defined in the opinion as someone who has a "stake" or "interest" in the purity and outcome of a securities transaction.

> "The plaintiffs in this case were certainly 'investors' in the transaction which is allegedly tainted by fraud. Their interest as stockholders of Bank Service Corporation was apparently sufficient to induce them to execute substantial personal guaranties. As individual guarantors they were direct parties to the transaction in dispute. If, as plaintiffs have alleged, the transaction was consummated in violation of the Rule 10b-5, we believe the plaintiffs, as investors and as principals in the transaction, suffered a legal injury which may be redressed by a federal court." 490 F. 2d at pp. 659-660.

It is submitted that the plaintiffs in the present case have no less an interest or stake in the securities transaction which is the subject of this action; moreover, the Eason court cited with approval the opinion below in the case at bar. (490 F. 2d at p. 660, n. 25.)

While concurring that the Birnbaum decision has been often misinterpreted and thus has created a variety of apparent conflicts, respondent does not believe that a total striking down of Birnbaum is necessary to a disposition of the case at bar. If Birnbaum, as suggested herein, stands for the sole proposition that §10(b) is not a vehicle for correcting corporate mismanagement, then the doctrine has no application here since corporate mismanagement is not made an issue. If Birnbaum legitimately establishes a standing requirement, the respondent submits that it satisfies

that requirement by virtue of its unique causal relationship to the transaction in question.

This Court has stated that Congress intended that securities legislation enacted for the purpose of avoiding frauds should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes. [18] With this in mind and recognizing the line of cases which granted standing to non-purchasers and non-sellers where a causal nexus or contractual relationship existed, the Court below found that respondent had satisfied any such "standing" requirement by virtue of its unique relationship to the transaction and its concomitant right or entitlement to purchase the subject shares for a fixed quantity and price and at a specified time. (App. at 138 through 142.) The Court of Appeals held the rights or relationship which flowed from the consent decree served the same function as did the contractual relationship exception in the Puretec, Hentz and Stockwell genre of cases. The Court noted, however, that the amended complaint under review presented a highly unusual situation in which an unyielding insistence upon the existence of a contract to purchase as a prerequisite to relief would subordinate substance to form. (App. at 155.)

A highly unique set of circumstances is presented here. We have the novel, atypical situation in which an issuer of securities is required to make a specific offer, yet an offer which it hopes will go unaccepted. Those circumstances must be considered in application to the broad

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18 Affiliated Ute Citizens v. United States, 406 U.S. 128, 151; Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 12; SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186.

remedial function of section 10(b) and rule 10b-5 As stated in Herpich v. Wallace, 430 F. 2d 792, 806-7 (5th Cir. 1970):

> "In determining whether a plaintiff has standing, we search for what will best accomplish the Congressional purpose . . . Thus we construe the 'in connection with the purchase or sale of a security' clause found in both the section and the rule broadly and flexibly to effectuate that purpose . . . The 'purchaser'-'seller' standing requirement is to be similarly construed . . . so that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions . . ."

Respondent submits that each case brought under section 10(b) should be examined individually with particular concern for whether the fraud alleged is of the type and the plaintiff is of the class intended by Congress to be covered

by 10(b). [19] In this context, respondent would now turn to a more complete and informational description of their unique status and the circumstances which precipitated it.

B. Respondent had a unique right to purchase the securities of Blue Chip Stamps and thereby enjoyed a relationship equivalent to one of contract with petitioners.

The petitioners have consistently sought to place respondent in the extramural position of a mere bystander and thus outside the scope of 10(b) coverage. Respondent believes that the following excerpts from the record of the antitrust proceedings conclusively establish that respondent was anything but a bystander to those proceedings or an unwitting beneficiary of the eventually approved reorganization plan.

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[19] SEC v. National Securities, Inc., 393 U.S. 453, 467.

As is alleged in the amended complaint,[20] the "users" had contended that they owned an interest in Blue Chip Stamp Company and sought to have said ownership interest decreed. This claim was consistently agrued by the "users" as amici curiae. Included among the amici curiae was the Attorney General of the State of California, who had entered his appearance on behalf of all retail grocers who were not defendants in the anti-trust action. A portion of the class which respondent represents in this action would be such retail grocers. Also appearing jointly as amicus curiae were California Grocers Association and Certified Grocers of California, Ltd., who also included within their constituency a portion of the respondent class herein.

The material which follows was taken from the official court records and files in the anti-trust action. They were submitted to the Court

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20 App. at 10.

of Appeals in the form of a Supplemental Brief[21] and were relied upon in part[22] by that Court in reaching its decision.

In opposition to the first proposed consent decree the State Attorney General lodged the following objections:

> "It should be borne in mind that, in organizing Blue Chip, in their capacity as majority stockholders and promotors [sic] the defendant retailers caused it to be reported to the retail grocers of the State that Blue Chip would be non-profit to those who promoted it. It was in reliance upon such representation that several thousand retail grocers, not defendants in these proceedings, gave their patronage to Blue Chip, and gave it to such an

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21 This Supplemental Brief is reprinted herein at Appendix "B" to this brief; see, particularly, pages 11 through 35 of said Index.

22 App. at 135, n. 4.

extent that in the aggregate they accounted for not less than 2/3 of the patronage Blue Chip enjoyed during the ten years of its existence. In point of fact, Blue Chip has been operated without profit to its stockholders as such. Consequently, and with fairness to all, Blue Chip's present net assets, tangible and intangible over and above the paid-up value of its share of stock, should be regarded as beneficially belonging to the retail grocers who made it what it is today." (emphasis ours) (Brief of the State of California As Amicus Curiae, p. 42, ll. 19-31, p. 43, ll. 1-4, filed September 27, 1966)

The first proposed consent decree was withdrawn and a second draft was submitted for court approval. The court thereupon requested amici curiae to file briefs if opposition to the plan was found. The Attorney General filed his brief raising the same objection as above. The other amicus curiae filed its brief in which it traced

the history of Blue Chip Stamp company and the representations which had been made to the users and concluded:

"From its inception, Blue Chip was promoted as being run for the benefit of the users whose help was enlisted in its promotion.

"The consenting parties have not addressed any comments to this point. However, much as they would, they cannot close their eyes to the role of the non-defendant users and their very real equity in Blue Chip, its name, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made."

(emphasis ours) (Reply Brief Of California Grocers Association and Certified Grocers of California, Ltd., As Amicus Curiae, pp. 12-13, filed December 5, 1966)

Thriftimart, Inc., a petitioner herein, was a non-consenting defendant to the second proposed decree and filed a brief in objection which acknowledged the validity of the users' contention:

"Equally important, if not more important, is the fact that the consenting defendants cannot destroy the Blue Chip Stamp Company through the means of the Consent Decree without being guilty of fraud with respect to all of the grocers who relied upon their representations at the organization of Blue Chip and which representations were made repeatedly throughout the years to the present time.

"The grocers relied on these representations and acquired to the extent of their reliance and the extent of the representations

an equitable interest in the business of Blue Chip as equitable members of a de facto cooperative. (emphasis ours) (Reply Brief of Defendant Thriftimart, Inc. To Agrument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p. 19, ll. 22-32, filed December 6, 1966)

The Court then refused to enter the second proposed decree. A third decree was subsequently submitted and approved by the court on June 5, 1967. (App. at 23 through 35.) That court subsequently expressed its understanding of the import of the approved decree:

"The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamps industry in California, while at the same time preserving the legitimate interests of the users of Blue Chip Stamps." (emphasis ours) (Order Denying Motions To Intervene And To Vacate Consent Decree, p. 18, ll. 6-10, entered Aug-

ust 8, 1967.)

In a brief replying to objections to the proposed plan of reorganization submitted pursuant to paragraph V (App. 27) of the consent decree, the defendants, petitioners herein, said:

". . . The Reorganization Plan has two basic purposes and objectives, namely: (1) To divest control of the company by the present stockholders and broaden the base of ownership so as to dissipate the alleged (and denied) combination and restraint, and (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others in behalf of non-stockholder users. While the existence of such an equitable interest has been denied, it can fairly be said that the claims which had been so asserted were such that the Board of Directors of Blue Chip could properly and in good faith determine that they were worthy of being compromised.

* * *

"There is the additional fact that a valuable consideration moved from the Blue Chip shareholders to present Blue Chip which fully justifies its agreement to protect its shareholders, officers, and directors from liability. Certainly, it was and is in the interest of Blue Chip to settle the Government action without trial. It became apparent that such settlement could not be achieved without offering non-stockholder users an opportunity to acquire an equity interest at a price substantially equivalent to that originally paid by the present stockholders." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p. 9 ll. 3-17, filed August 22, 1967)

Petitioners have contended herein that the unique interest or right claimed by respondent is a fiction since neither the consent decree nor the plan of reorganization makes mention of any such interest or "bargain" offering. Yet, in a hearing subsequent to Court approval of the consent decree and plan of reorganization, Mr. William W. Alsup on behalf of Blue Chip Stamps conceded that the "users" were intended to be benefited by the consent decree and plan of reorganization thereunder:

"MR. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users, are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (Reporter's Transcript Of Proceedings, Monday November 4, 1968, Thursday, November 7, 1968, p. 12, ll. 8-12.)

Furthermore, as to the "bargain" aspect of

the offering petitioners would seek to have both sides of the argument. In conjunction with the hearing above mentioned, Mr. Alsup wrote:

"We cannot agree that the service station operators (a portion of the users represented by respondent herein) could be so lacking in time and financial sophistication that they will be unable to make a bank loan, and particularly so on an offering which it is conceded will be of substantial benefit to them." (insert and emphasis ours) (Memorandum Of Blue Chip Stamps In Support Of Contention That The Raley's Options And Assignments Should Be Declared Invalid, pp. 4-5, filed November 7, 1968.)

The other party-litigant in the anti-trust litigation, the United States Government, through its counsel Stanley E. Disney, Assistant U.S. Attorney, agreed with the assessment that the offering was a "bargain":

"MR. DISNEY: With reference to the decree,

the intent of the decree, he said that distributing 45% of the shares to users was intended basically to achieve two purposes. First to give the user the shares at bargain prices and hope that they would retain those shares;

"MR. DISNEY: But on the basis of the record as it stands I think that many small users had made bad bargains and if there is any way to -- and I think that we intended in the decree to see that they got a good bargain. (emphasis ours) (Reporter's Transcript Of Proceedings, Monday, November 4, 1968, p. 78, ll. 9-17, p. 88, ll. 1-4.)

At the same hearing, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"MR. HOWLAND: What we have here is a provision in the plan of reorganization that created and brought into existence a right or entitlement in the users of Blue Chip Stamps.

* * *

"And to make sure that the users knew of this right and entitlement there had been conferred upon them by the order of this court, the plan then required advertisements in newspapers, and that a form on which the user could establish his usage would be sent out to all users, and that thirty days after the publication of the first such advertisement the right of users to establish their usage shall terminate.

* * *

* * *

"So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization approved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis

ours) (Reporter's Transcript, supra, pp. 41-43.)

The reason for the rather lengthy exposition of the record in the antitrust action is, hopefully, to demonstrate the clear understanding and intention of the parties with respect to the subject offering. Respondent feels that it is not honest or fair for the petitioners to claim that the offering was not intended to be a bargain in recognition of a right or interest [23] of the users in Blue Chip Stamp Company.

Respondent submits that the court below was justified and correct in finding that the present case presents a highly unusual situation in which

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23 Respondent submits that this is the type of "intent" or "stake" suggested in the Eason case, supra, which raises the complaining party to the requisite position of an "investor" in the transaction. Moreover, this Court has referred to the injured party as an "investor" as opposed to a purchaser or seller. Affiliated Ute Citizens v. United States, 406 U.S. 128, 151; Superintendent of Insurance v. United States v. United States, 404 U.S. 6,12.

an unyielding insistence upon the existence of a contract to purchase as a prerequisite to relief would subordinate substance to form. (App. at 155.)

C. Granting standing to respondent does not conflict with the Securities Act of 1933 or create an impossible burden for furture issuers of securities.

Peitioners make two alarmist arguments: (1) that the decision below opens the floodgates to unlimited 10(b) actions and (2) creates an impossible burden for future prospectus draftsmen in light of the disclosure policy of the Securities Act of 1933.

Even if one were to assume that an affirmation of the Court of Appeals decision would expose future offerors of securities to draconian damage claims and strike suits, as suggested by Justice Hufstedler in her dissenting opinion (App. at 151, respondent submits that such a doomsday prediction is not a relevant or justifiable basis

for denying relief to respondent herein. Although 10b-5 may well be the most litigated provision in the federal securities field, it has never been suggested that the increase in 10(b) actions is due to the creation of exceptions to the Birnbaum rule, such as in the aborted purchaser or seller cases cited infra. Petitioners are, in effect, suggesting that the defrauded party should be the one to suffer rather than the perpetrators of the fraud.[24]

The Court in Eason v. General Motors Acceptance Corporation, 490 F.2d 654 (7th Cir. 1973) considered the policy argument that further erosion or an abandonment of Birnbaum would lead to an unmanageable flood of federal litigation. In fact, the Eason court explicitly referred to Justice Hufstedler's dissent when it held:

> "The volume of 10b-5 litigation has already expanded dramatically and will no doubt

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[24] 490 F.2d 654, 661, n. 25.

continue to do so whether or not the purchaser-seller limitation is rejected. The extent to which a refusal to adhere to Birnbaum will affect that volume is really a matter of speculation The fact that the purchaser-seller limitation is unacceptable does not mean that there will be no limit of any kind of the availability of private relief. For in each case the plaintiff will have to demonstrate membership in the 'special class' protected by Rule 10b-5 and injury as a direct consequence of the alleged violation. The number of parties who may invoke Rule 10b-5 without the purchaser-seller limitation may not differ materially from the number who would recover by persuading a court to interpret the purchaser-seller concept flexibly." 490 F.2d at 660.

The Eason decision also notes that this Court expressed no such fear in its expansion of 10(b) coverage in Superintendent of Insurance v. Bankers

Life & Casualty Co., 404 U.S. 6, 24. [25]

The decision below, however, does not subject future issuers to unlimited 10(b) damage actions. Respondent stresses that the facts and circumstances of the case at bar, as recognized by the majority opinion, are unique and can be properly restricted to this singular offering. Respondent has never suggested that permitting it to have its day in court would cause a rent in the the curtain which repels totally speculative claims of bystanders to securities transactions.

An equally unjustified but calamitous consequence raised by petitioners is that future prospectus draftsmen will find it an impossible burden to reconcile the disclosure policy of the Securities Act of 1933 with an unbridled opening of the class of 10(b) claimants. But, the 1933 Act merely requires that an issuer disclose ad-

25 490 F.2d 624, 661.

verse factors connected with an offering; it does not mandate or sanction over-emphasis of partially true or wholly illusory negative factors, as is alleged in the present action. [26] As petitioners state in their brief, the 1933 Act expresses a policy of full disclosure, not false pseudo-disclosure.

Interestingly, petitioners cite [27] as authority for this supposed irreconcilable conflict between the two Acts certain legislative history (H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933)), which explicitly states that:

> "The purpose of the 1933 sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited." (emphasis ours)

Because of the alleged fraud of petitioners,

26 App. at 15 through 17.

27 Petitioners' brief at pp. 37-38.

respondent never technically became more than a potential buyer. It is submitted, therefore, that petitioners have not satisfied even the basic policy of the 1933 Act. If a true conflict is created between the 1934 and 1933 Act it certainly has not troubled the department charged with the administration and enforcement of those laws. As has been mentioned above, the Securities and Exchange Commission has urged that this Court go a step beyond the position taken by respondent and totally abolish the Birnbaum doctrine. Again, respondent is willing to concede that the Court of Appeals' decision is applicable only to the present case; but, even if it were not and it thereby created a different problem for future issuers, such a difficulty is not one which is insurmountable for the Commissioner to alleviate by appropriate regulation.

As was noted by this Court in Flast v. Cohen, 392 U.S. at 94, n. 9, where the standing of a taxpayer was challenged, fears of overburdening

the courts are mitigated by the ready availability of the devices of class actions and joinder under the Federal Rules of Civil Procedure and by the increased ability of the federal courts, through experience in recent years, to cope effectively with "huge litigations and redundant actions."

Petitioners' contention that respondent should be foreclosed from pursuing this action because its claim for damages is too speculative [28] is not properly an issue in a motion to dismiss for lack of standing. The rule denying recovery of speculative damages is applicable only where there is

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28 Petitioners also question whether respondent has alleged a compensible loss under 10(b) in that because there has been no technical purchase or sale there has been, thus, no "out of pocket" loss. 15 U.S.C. §78bb, however, provides that the measure of damages in a §10(b) action shall be "actual damages" sustained as a result of the act complained of. This further illustrates the enigmatic position of petitioners, who would seek evasion of the anti-fraud purpose of §10(b) because they were so "successful" as to dissuade respondent from purchasing any of the offered securities.

uncertainty as to the reality of damages, rather than uncertainty as to their amount or measure As was held in Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 563-65 (1931), where it is certain that damages have been suffered the defendant will not be absolved from liability because of the uncertainty of the amount but the trier of fact will make the most intelligent estimate of the amount of damages to which the plaintiff is entitled as the nature of the case permits. [29]

Furthermore, the respondent's claim for damages is not the sole relief requested. Respondent has prayed in the alternative for the right to purchase the offered securities of Blue Chip Stamps at the price and upon the terms specified

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29 See, also, Commerce Reporting Company v. Puretec, Inc., 290 F. Supp. 715, 719 (S.D. N.Y. 1968); Site v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N. Y. 1971).

in the subject offering (App. at 22).

II.

RESPONDENT HAS NOT CONTENDED NOR DOES THE COURT OF APPEALS OPINION HOLD THAT STANDING HEREIN HAS ANY RELEVANT CONNECTION WITH ENFORCEMENT OF A CONSENT DECREE BY A THIRD PARTY.

There is nothing express or implicit in the opinion below which suggests that the respondent seeks to enforce the prior consent decree. Respondent's emphasis upon the facts and circumstances surrounding the consent decree and the Court of Appeals' discussion thereof serve as important historical and causal background concerning the unique status which respondent enjoyed with respect to the subject "bargain" offering. Respondent prefers to characterize the consent decree not as the alleged "right" itself, but rather

as the source from which a legally cognizable right eventually flowed.

Although the case of United States v. Armour & Co., 402 U.S. 673 (1971) is correctly cited for the proposition that a non-party to a consent decree may not enforce that decree directly or in a collateral proceeding, respondent submits that this principle has little to do with the case at bar. The majority opinion below best articulates the distinction respondent seeks to establish:

> "The rule referred to does not bar the claim before us, however. This claim rests upon the theory that plaintiff-appellant was damaged by a violation of the Securities Exchange Act of 1934 and Rule 10b-5 prohibiting fraud in connection with the purchase or sale of securities. The fact that the securities transaction that is the subject matter of the claim was mandated by the consent decree does not immunize defendant-appellees from the statutes and rules regulating securities

> transactions. Plaintiff-appellant relies upon a breach of a duty imposed by these statutory anti-fraud provisions, not upon a breach of a duty imposed by the consent decree. (App. at 141-142, n. 4.)

Had the court reasoned that respondents were hereby attempting to enforce the decree it would not have analyzed its status as one which is the "functional equivalent" of a contractual relationship. If respondent were enforcing or entitled to enforce the consent decree, an actual contractual relationship would have been established. Such is not the import of the court's language or the thrust of respondent's contentions.

CONCLUSION

For the foregoing reasons the decision of the Court of Appeals should be affirmed and the case

remanded to the District Court for further proceedings.

Respectfully submitted,

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January 29, 1975

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APPENDIX A

APPENDIX A

15 U.S.C. §78bb:

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

APPENDIX B

APPENDIX B

UNITED STATES COURT OF APPEAL

FOR THE NINTH DISTRICT

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps, Plaintiff-Appellant, vs. BLUE CHIP STAMPS, BLUE CHIP STAMP COMPANY, LUCKY STOES, INC., MARKET BASKET, PURITY STORES, INC., RALPHS GROCERY COMPANY, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO, INC., VON'S GROCERY CO., ROBERT E. ALEXANDER, DONALD A. KOPPEL, LEONARD H. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R.	)	No. 71-2223 PLAINTIFF-APPELLANT'S SUPPLEMENTAL BRIEF

NIVEN, FRED VON DER AHE,)
)
Defendants-Appellees.)
)

I. PRELIMINARY STATEMENT

In response to the Court's order, plaintiff-appellant herewith submits its brief regarding the recent Ninth Circuit decision in Mount Clemens Industries, Inc. v. Bell, No. 71-1318, decided June 28, 1972. The Securities Exchange Commission, which has appeared heretofore in this proceeding as amicus curiae, has likewise been requested to file a brief. It is plaintiff-appellant's understanding from conversations with Securities Exchange Commission's counsel that their brief will primarily urge that the Mount Clemens decision be rejected in toto by this Court. While we join in the brief of the Securities Exchange Commission and the agruments raised therein, at the same time we feel that the Mount Clemens case supports the posi-

tion that has been consistently urged by plaintiff-appellant herein. Although we feel that the Mount Clemens case and the one at bar present dissimilar facts and therefore necessarily different questions before the Court, we nevertheless feel that much of the language of the Mount Clemens opinion and the crux of the rationale support and affirm this plaintiff-appellant's contentions.

Although we share in the Security Exchange Commission's disappointment over the Court's refusal to disaffirm the Birnbaum doctrine in toto, we do not find the Mount Clemens decision to be a hindrance in any other respect. The Mount Clemens case is easily distinguished from the one at bar. There, certain corporate securities were offered at an ordinary public auction. Plaintiffs were merely members of the general public interested in purchasing the subject securities. Defendant represented to the plaintiffs

that the securities were worthless and it is alleged that the plaintiffs were thereby induced not to bid at the sale. There was no allegation by the plaintiffs that they enjoyed any status or had any special rights other than that of all other members of the public. There was no previous relationship between the parties which gave rise to any duty on the part of the defendant or any "right" on behalf of the plaintiffs to engage in the securities transaction. The Court in Mount Clemens made the following observation which we contend to be of significant importance:

> Plaintiffs were not even induced to refrain from accepting an outstanding offer" (emphasis ours)(Slip. Op. at page 10, footnote 11.)

The gravamen of the amended complaint in the present case concerns and alleges the very existence of an outstanding offer. (Amended Complaint, paragraph XVI, R.13) Additionally, it is alleged in our Amended Complaint that the "Users"

herein enjoyed a unique status, which status "Prompted The Plan and the offering." (Amended Complaint, paragraph X, R.6-7, 1.28)

We contend, therefore, that the crucial question before this Court is whether or not the plaintiffs-appellants herein possessed a special and exclusive right or owned an equitable interest within the protective provisions of Section 10(b). If the Court concludes that the complaint does not allege with sufficient clarity the special right of plaintiff's to purchase the offered stock, plaintiffs ask leave to amend the complaint to conform to the following facts.[1]

In light of certain of the language in the Mount Clemens decision and by virtue of certain deductions the undersigned has made as a result of the Court's questions at the time of oral argument

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1 . . . . (T)he accepted rule (is) that a complaint should not be dismissed for failure to state a claim unless it appears beyond a reasonable doubt that the plaintiff can prove no set of factors in support of his claim which would entitle him to relief." Conley vs. Gibson, (1957). 355 U.S. 41, 46, 78 S.Ct. 99, 102, 2L. Ed. 2d 80.

of this matter, this brief will be limited to an elucidation of the status of the plaintiff-appellant at the time of the subject violation of Section 10 (b).

II. THE MOUNT CLEMENS DECISION SUPPORTS PLAINTIFF-APPELLANT'S CONTENTION THAT IT HAS "STANDING" UNDER SECTION 10 (b) OF THE SECURITIES EXCHANGE ACT OF 1934.

Initially, it must be noted with much importance that the Mount Clemens opinion specifically adopts the view which has been persistently urged by plaintiff-appellant throughout these proceedings, to wit: that a plaintiff is not dependent upon an actual purchase or sale in order to state a cause of action under Section 10(b). Specifically, the Court stated:

> "These allegations clearly reveal that plaintiff never actually purchased or sold the Missile stock. Yet that circumstance does not end our inquiry, for under the liberal inter-

pretation that has sometimes attended the application of the Birnbaum Doctrine there have been cases in which standing has been afforded to persons who, even though not actual purchasers or sellers, have been deemed to have the required status. (citing cases)" (Slip. Op. at page 9)

Consequently, the Mount Clemens decision lays to rest a major issue regarding which both appellant and appellee devoted much of their previous briefs. Therefore, despite defendants-appellees' repeated arguments to the contrary, the amended complaint here is not defective because it admittedly asserts that the "Users" were non-purchasers.

There can also be no question that the Mount Clemens decision holds that lacking the status of an actual purchaser or seller the plaintiff must demonstrate that it enjoys some other status for which relief should be afforded. The Court rec-

ognized that all of the cases which adopted the non-technical or liberal interpretation of the 10(b) (b) standing language found that the plaintiff enjoyed the status of "a party to a prior agreement to purchase or sell" securities. The Mount Clemens Court observed that the cases which fall into the "aborted purchaser-seller cases" ((Opper vs. Hancock Secs. Corp., 367 F. 2d 157 92d Cir.), Aff'g. 250 F. Supp. 668 (S. D. N. Y. 1968); Goodman vs. H. Hentz & Co., 265 F. Supp. 440 (N. D. Ill. 1967); Stockwell vs. Reynolds & Co., 252 F. Supp. 215 (S. D. N. Y. 1965)) all presented evidence of such a prior agreement or "contractual relationship". At the same time, the Court noted:

"We recognize that the term 'contract' in Sections 3(a) (13) and 3(a) (14) must be given a broad, liberal interpretation (citing cases)." (Slip. Op. at page 11, footnote 12.)

As is obvious from the very title of the cate-

gory of such cases, each of the plaintiffs in the "aborted purchaser-seller" cases was frustrated from consummating a specific purchase or sale of securities. The courts, of course, did not deny these plaintiffs relief merely because they were never able to engage in the particular securities transaction. Rather, they were afforded standing under Section 10(b) because they had a right to participate in the transaction in question. In those cases above cited, the rights of the plaintiffs flowed from an agreement or a contract. We submit that the plaintiff-appellant herein similarly had a right to engage in a specific transaction. That right emanates from a court decree, based upon a stipulation (contract) in the government anti-trust case. The decree singled out the plaintiffs ("Users") and gave them a special right, distinct, unique and exclusive from the "man on the street" plaintiff in the Mount Clemens case.

We wish, therefore, to present to this Court the following historical, legal data which is the font of this entire litigation and from which flowed the status of the plaintiff-appellant ("Users"). We therefore request that this Court take judicial notice of those citations and quotations from the record of the previous anti-trust lawsuit. 2

III. THE RECORDS AND PLEADINGS OF THE GOVERNMENT ANTI-TRUST SUIT ESTABLISH THAT "USERS" HAD A "RIGHT" TO PURCHASE BLUE CHIP STAMP'S SECURITIES

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2. Federal Appellate Court may take judicial notice of matters, even though not brought to the attention of the lower court, where necessary to show the impropriety of the lower court decision. International Brotherhood of Teamsters, Chauffers, Warehousemen, and Helpers of America vs. Zantop Air Transport Corp., 394 F.2d 36 (6th Cir. 1968)

As is alleged in the Amended Complaint (R. 4-6) and has been briefed and argued in these proceedings, the basis of plaintiff-appellant's claim under Section 10(b) stems from the Consent Decree entered June 5, 1967 by the United States District Court in United States of America vs. Blue Chip Stamp Company, et al., No. 63-1552. This was a civil anti-trust action in which it was alleged in substance that the defendants had conspired to restrain competition in the trading stamp industry in California and had obtained an illegal monopoly therein. A chronological history of that litigation establishes the genesis of the "Users" "rights" herein and the total fallacy in the defendants' contention that the "Users" had no more than an "opportunity" to purchase the securities in question.

The records in that case reveal that:

On July 29, 1966, the United States Government as plaintiff and all but two of the defend-

ants therein agreed to and lodged with the Court a proposed consent decree. Said decree made no provision concerning any offering of securities to "Users"; nor was there any mention or recognition of said "Users".

The two non-consenting defendants were Thriftimart, Inc. and Market Basket. They were most adamant in their refusal to stipulate to the proposed consent decree and urged that the implications of any such decree would have a tremendous impact on the grocery and other retail industries in California which subscribed to Blue Chip's stamp program and the very economy of California in general. Thriftimart therefore petitioned the Court that the "retail customers" of Blue Chip be brought into the action as indispensible parties plaintiff or parties defendant (Motion of Thriftimart, Inc. For Order Re Proposed Final Judgment By Stipulation, filed July 29, 1966.)

The Court thereupon permitted the entry into the case by various amici curiae, among which was the Attorney General of the State of California. The Attorney General entered his appearance on behalf of all retail grocers of California who were non-defendants and in his capacity as parens patriae. (Amended Complaint, paragraph IX, R. 23) The above-mentioned retail grocers therefore included a large number of the plaintiff-"Users" herein. On September 27, 1966, the California Attorney General filed his brief in opposition to the entry of the first proposed consent decree. Therein he stated:

> "It should be borne in mind that, in organizing Blue Chip, in their capacity as majority stockholders and promotors [sic] the defendant retailers caused it to be reported to the retail grocers of the State that Blue Chip would be non-profit to those who promoted it. It was in reliance upon such representation

> that several thousand retail grocers, not defendants in these proceedings, gave their patronage to Blue Chip, and gave it to such an extent that in the aggregate they accounted for not less than 2/3 of the patronage Blue Chip enjoyed during the ten years of its existence. In point of fact, Blue Chip has been operated without profit to its stockholders as such. Consequently, and with fairness to all, Blue Chip's present net assets, tangible and intangible over and above the paid-up value of its share of stock, should be regarded as beneficially belonging to the retail grocers who made it what it is today." (emphasis ours) (Brief of the State of California As Amicus Curiae, p. 42, ll. 19-31, p. 43, ll. 1-4, filed September 27, 1966)

On October 3, 1966, the government-plaintiff withdrew its approval of the proposed consent decree.

On October 28, 1966, a second proposed consent decree was lodged with the Court. This decree was substantially the same as its predecessor and again contained no provision for an offering of securities to non-defendant "Users" or otherwise any mention or recognition of that class. On October 28, 1966 by its Order of same date, the Court instructed defendants and amici curiae to file objections to the second proposed consent decree.

On November 15, 1966, the State Attorney General filed its brief objecting to the proposed decree. Again he objected to the decree's failure to recognize the beneficial or equitable interest of the non-defendant "Users":

> "Blue Chip's present net assets, tangible and intangible, over and above the paid-up value of its shares of stock, should be registered as beneficially belonging, in proportion to their patronage, to all the retailers who made it

> what it is today." (Brief Of The State Of California As Amicus Curiae, p. 77, ll. 8-12, filed November 15, 1966)

As an appendix to his brief, the Attorney General submitted a proposed consent decree which provided that upon dissolution of Blue Chip Stamp Company there be a distribution of its assets on a pro rata basis to the non-defendant "Users".

Also appearing in an amicus curiae stature were jointly, the California Grocers Association and Certified Grocers of California, Ltd. On December 5, 1966, they filed their brief in opposition to the second proposed consent decree and after tracing the origin and development of the Blue Chip Stamp Company and the representations which had been made to the non-defendant "Users", urged the Court:

> "Out of this abundance of successful cooperative experience, the independent retailers of California believe that Blue Chip Stamp

Company should be controlled and owned by the users, directly or indirectly." (emphasis ours) (Memorandum On Behalf Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, p. 37, ll.19-22, filed November 14, 1966)

Thriftimart, Inc. once again objected and filed its brief in opposition to the second proposed decree. Reiterating its concern that the "Users" be joined as indispensable parties, Thriftimart in support of its contentions noted the aforementioned claims by the amici curiae:

"As a result of this position, Certified Grocers and the California Grocers Association have taken the position that the assets of Blue Chip are held in trust for the users to the extent which these representations warrant." (emphasis ours) (Objections And Opposition (Of Thriftimart, Inc.) To Entry Of Second

Proposed Consent Decree, Lodged October 28, 1966.)

The government-plaintiff and the consenting defendants filed briefs in response to the foregoing memoranda and, in general, urged that the proposed decree was fair and equitable to all concerned and that there was no just reason for delay in its entry.

A reply brief by California Grocers Association and Certified Grocers of California, Ltd. commented upon the plaintiff's and defendants' briefs and further emphasized the unrewarded claim of the non-defendant "Users".

"From its inception, Blue Chip was promoted as being run for the benefit of the users whose help was enlisted in its promotion.

"The consenting parties have not addressed any comments to this pooint. However, much as they would, they cannot close their eyes to the role of the non--defendant users and

their very real equity in Blue Chip, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made." (emphasis ours) (Reply Brief Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, pp. 12-13, filed December 5, 1966)

Thriftimart, Inc., also replied to the briefs of the plaintiff and the consenting defendants in support of the second proposed consent decree, and although a defendant in the case at bar, it would appear from the following language of its

brief that Thriftimart fully aligned itself with the "Users":

> "Equally important, if not more important, is the fact that the consenting defendants cannot destroy the Blue Chip Stamp Company through the means of the Consent Decree without being guilty of fraud with respect to all of the grocers who relied upon their representations at the organization of Blue Chip and which representations were made repeatedly throughout the years to the present time.
>
> "The grocers relied on these representations and acquired to the extent of their reliance and the extent of the representation an equitable interest in the business of Blue Chip as equitable members of a de facto co-operative." (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Con-

senting Defendants, p. 19, ll. 22-32, filed December 6, 1966)

Thriftimart went on to state:

"It was on the basis of these representation oft repeated that the grocers of California came into the Blue Chip plan in order that they might remain competitive with those having the Sperry and Hutchinson franchised S & H green stamp. All went into the program. They made it a success. It was the money of the members as much as the backing of the stockholders that made possible Blue Chip and saved the grocery industry from monopoly. These facts, among others, are the background for the position of Certified Grocers and the California Grocers Association that they have a beneficial interest in this company. (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p. 24, ll. 6-15, filed December 6, 1966)

After three days of oral argument, the Court refused to enter the second proposed consent decree. (Court Minutes of December 15, 1966) There can be no doubt as to Judge Ferguson's reason for declining to sign the decree as is evidenced by his following statement in a hearing on objections to a third proposed consent decree:

"THE COURT: I have read it (third proposed consent decree) hundreds of times. Please don't make me go through it again.

"Answer my question, as a pragmatic service station operator, if you can convince me that this decree is going to do injury to you I probably won't sign it. But you are going to have to convince me on that level.

"MR. DOWNEY: That's right.

"THE COURT: The grocerystore people convinced me last time. Now if you, as a ser-

vice station operator, can convince me this time more power to you. But you are not going to convince me on any other kind of approach." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p. 466, ll. 5-17)

* * *

"THE COURT: There is a difference, there is a difference. Mr. Howland (Assistant State Attorney General) convinced me last time about the grocery stores." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p. 477, ll. 12-14)

On April 28, 1967, a third proposed consent decree was lodged with the Court. This, of course, was the Consent Decree which was eventually signed on June 5, 1967 and thereafter put into operation. (Amended Complaint, paragraph VI, R. 4) It was pursuant to paragraph V of said Consent

Decree (R. 22), in which the defendants were ordered to present to the Court within 60 days a plan of reorganization of Blue Chip Stamp Company, that the defendants filed and had approved the plan of reorganization (R. 35) containing the offer to "User".

All of the parties and aforementioned amici curiae approved the Consent Decree. Certain other amici curiae objected to it (e.g. Independent California Service Station Operators, Gold Bond Stamps, etc.). In reply to their objections, the plaintiff-government commented on the considerations which had been involved in drafting the third proposed consent decree:

> "The proposed Final Judgment lodged with the Court on April 28, 1967 was agreed to by the United States only after long and complicated negotiations extending over two years In drafting this decree, earnest consideration was given to the views of the Court express-

ed on December 15, 1966. Oral and written views of counsel for defendants, the State of California, Certified Grocers' Association, all of whom approve the proposed decree, were received and considered by the Department of Justice, as well as the views of all parties interested in opposing the decree. (Plaintiff's Memorandum In Reply To Memorandum Filed In Opposition To Proposed Final Judgment Lodged With The Court April 28, 1967, p. 5, ll. 12-21, filed May 26, 1967)

In seeking Court approval of the Reorganization Plan and in defense of their "bargain offering" to "Users", the defendants stated:

> " . . . The Reorganization Plan has two basic purposes and objectives, namely: (1) To divest control of the company by the present stockholders and broaden the base of ownership so as to dissipate the alleged (and denied) combination and restraint, and (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others in behalf of non-stockholder users. While the existence of such an equitable interest has been denied, it can fairly be said that the claims which had been so asserted were such that the Board of Directors of Blue Chip could properly and in good faith determine that they were worthy of being compromised." (emphasis ours) (Reply To Memorandum of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967), p. 9, ll. 3-17, filed August 22, 1967)

If it is not clear from the above, it is manifestly so from the following, that the present defendants recognized the "right" or equitable in-

terest of the "Users" and incorporated them into the plan of reorganization and Consent Decree:

> "There is the additional fact that a valuable consideration moved from the Blue Chip shareholders to present Blue Chip which fully justifies its agreement to protect its shareholders, officers, and directors from liability. Certainly, it was and is in the interest of Blue Chip to settle the Government action without trial. It became apparent that such settlement could not be achieved without offering non-shareholder users an opportunity to acquire an equity interest at a price substantially equivalent to that originally paid by the present stockholders." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p. 7, ll. 7-8, filed

August 22, 1967)

If there be any doubt that the Court, too, recognized this equitable interest in the "Users" and intended that it be accounted for in the Consent Decree, such doubt is allayed by the Courts' following statement:

> "The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamp industry in California, while at the same time preserving the legitimate interests of the users of Blue Chip Stamps." (emphasis ours) (Order Denying Motions To Intervene And To Vacate Consent Decree, p. 18, ll. 6-10, entered August 8, 1967)

In addition, the very fact that the offering of securities to the "Users" was at a bargain price compels the conclusion that the defendants recognized that the "Users" possessed the claimed equitable interest or right. Despite defendants'

contentions to the contrary, there is no question, as will be seen infra, that the offering to the "Users" was intended to be and was, in fact, at a "bargain".

In a hearing subsequent to Court approval of the Consent Decree and Plan of Reorganization, Mr. William W. Alsup on behalf of Blue Chip Stamps conceded that the "Users" were intended to be benefitted by the Consent Decree and plan of reorganization thereunder:

"Mr. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (Reporter's Transcript Of Proceedings, Monday, November 4, 1968, Thursday, November 7, 1968, p. 12, ll. 8-12)

Furthermore, it was conceded that the offer-

ing was to be of substantial benefit to the "Users":

> "In our reply filed August 22, 1967 to the memorandum in opposition of Independent California Service Station Operators we discussed the financing arrangements available through the Bank of America and stated in part:
>
> * * *
>
> "'If the service station operators are, even remotely, as unsophisticated financially as counsel suggest, then if subscription rights were transferable there could be considerable danger they could be persuaded to give up their right to subscribe for a grossly inadequate price.
>
> "'Certainly there is nothing illegal in restricting transferability of a rights offering and, since there is no restraint on the stock itself there is no restraint on alienation of property, i.e., the stock and debentures.

"'We cannot agree that the service station operators could be so lacking in time and financial sophistication that they will be unable to make a bank loan, and particularly so on an offering which it is conceded will be of substantial benefit to them.'" (emphasis ours) Memorandum Of Blue Chip Stamps In Support Of Contention That The Raley's Options And Assignments Should Be Declared Invalid, pp. 4-5, filed November 7, 1968)

The other party-litigant in the anti-trust litigation, the United States Government, through its counsel, Stanley E. Disney, Assistant U.S. Attorney, agreed with the assessment that the offering was a "bargain":

"MR. DISNEY: But on the basis of the record as it stands I think that man[illegible]l users had made bad bargains and if there is any way to -- and I think that we intended in the decree to see that they got a good bargain."

(emphasis ours) (Reporter's Transcript Of Proceedings, supra, p. 78, ll. 9-17.)

At the same hearing, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"MR. HOWLAND: What we have here is a provision in the plan of reorganization that created and brought into existence a right or entitlement in the users of Blue Chip Stamps.

* * *

"And to make sure that the users knew of this right and entitlement there had been conferred upon them by the order of this court, the plan then required advertisements in, newspapers, and that a form on which the user could establish his usage would be sent out to all users, and that thirty days after the publication of the first such advertisement the right of users to establish their us-

age shall terminate.

* * *

"So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization proved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis ours) (Reporter's Transcript, supra, pp. 41-43)

III CONCLUSION

We therefore submit that it is clear from the foregoing exposition that: the "Users" emphatically asserted in the anti-trust action an equitable interest or right, that interest or right was recognized by the Court, the defendants, the government-plaintiff, and the various amici curiae on behalf of the "users" incorporated in the

Consent Decree and Plan of Reorganization thereunder, and that the "Users" must be afforded the appropriate relief under Section 10(b) in protection of that interest or right.

Thus, we repsectfully request that this Court reverse the Order below and permit this matter to be heard on its merits.

Respectfully submitted,

Dated: August 15, 1972 Brandlin, Ryan & McAllister

By: _____
James E. Ryan

Attorneys for Plaintiff-Appellant

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